IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

Income Tax Appeal No.107 of 2003
Date of decision: October 12, 2006

Commissioner of Income-tax (Central), Ludhiana

v.

M/s Munjal Sales Corporation, Ludhiana

Present: Mr. S.K.Garg, Advocate for the appellant.
Mr. Akshay Bhan, Advocate for the respondent.

CORAM:
Hon'ble Mr.Justice Adarsh Kumar Goel
Hon'ble Mr. Justice Rajesh Bindal

Rajesh Bindal, J.

This appeal by the revenue is directed against order dated 1.1.2003, passed by the Income-tax Appellate Tribunal, Chandigarh Bench `B' (for short, `the Tribunal') in I.T.A. No. 1296/CHANDI/96, for the assessment year 1993-94, raising the following substantial questions of law:

> "Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in deleting the disallowance of interest of Rs. 2,79,413/- on the grounds that there is no direct nexus between the borrowing and interest-free advances made to certain parties ?

During the course of assessment, it was found that the assessee had incurred liability to pay interest to the persons from whom the loans were raised, whereas on the other hand sums were advanced on interest free basis to M/s Brijmohan Lal & Associates; Mrs. Rama Munjal and M/s S.K. Rai & Sons. Considering the fact that the loans raised to the extent the same were advanced on interest free basis to other persons were not required to be raised, the Assessing Officer disallowed the interest to that extent. In appeal before the Commissioner of Income-tax (Appeals), the assessee failed. However, before the Tribunal, the plea

of the assessee was accepted on the ground that nexus of the funds advanced with the funds borrowed by the assessee was not established.

We have already considered an identical issue in Commissioner of Income-Tax v. Abhishek Industries Ltd., (2006) 286 ITR 1, wherein this Court held as under:

> "As far as the issue of establishment of nexus of the funds borrowed vis-a-vis the funds diverted towards sister concern on interest free basis is concerned, in our view, the stand of the assessee that the onus of proving the nexus of funds available with the assessee with the funds advanced to the sister concerns without interest is on the Revenue is not correct. Section 36(1)(iii) of the Act provides for deductions of interest on the loans raised for business purposes. Once the assessee claims any such deduction in the books of accounts, the onus will be on the assessee to satisfy the Assessing Officer that whatever loans were raised by the assessee, the same were used for business purposes. If in the process of examination of genuineness of such a deduction, it transpires that the assessee had advanced certain funds to sister concerns or any other person without any interest, there would be very heavy onus on the assessee to be discharged before the Assessing Officer to the effect that inspite of pending term loans and working capital loans on which the assessee is incurring liability to pay interest, still there was justification to advance loans to sister concerns for non-business purposes without any interest and accordingly, the assessee should be allowed deduction of interest being paid on the loans raised by it to that extent. In our view, even the plea of nexus of loans raised by the assessee with the funds advanced to the sister concerns on interest free basis, may be it is pleaded to be out of sale proceeds or share capital or different account cannot be accepted.
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> Entire money in a business entity comes in a common kitty. The monies received as share capital, as term loan, as working capital loan, as sale proceeds etc. do not have any different colour. Whatever are the receipts in the business, that have the colour of business receipts and have no separate identification. Sources has no concern whatsoever. The only thing sufficient to disallow the interest paid on the borrowing to the extent the amount is lent to sister

concern without carrying any interest for non-business purposes would be that the assessee has some loans or other interest bearing debts to be repaid. In case the assessee had some surplus amount which, according to it, could not be repaid prematurely to any financial institution, still the same is either required to be circulated and utilised for the purpose of business or to be invested in a manner in which it generates income and not that it is diverted towards sister concern free of interest. This would result in not presenting true and correct picture of the accounts of the assessee as at the cost being incurred by the assessee, the sister concern would be enjoying the benefits thereof. It cannot possibly be held that the funds to the extent diverted to sister concerns or other persons free of interest were required by the assessee for the purpose of its business and loans to that extent were required to be raised. We do not subscribe to the theory of direct nexus of the funds between borrowings of the funds and diversion thereof for non-business purposes. Rather, there should be nexus of use of borrowed funds for the purpose of business to claim deduction under Section 36(1)(iii) of the Act. That being the position, there is no escape from the finding that interest being paid by the assessee to the extent the amounts are diverted to sister concern on interest free basis are to be disallowed.

If the plea of the assessee is accepted that the interest free advances made to the sister concerns for non-business purposes was out of its own funds in the form of capital introduced in business, that again will show a camouflage by the assessee as at the time of raising of loan, the assessee will show the figures of capital introduced by it as a margin for loans being raised and after the loans are raised, when substantial amount is diverted to sister concerns for non-business purposes without interest, a plea is sought to be raised that the amount advanced was out of its capital, which in fact stood exhausted in setting up of the unit. Such a plea may be acceptable at a stage when no loans had been raised by the assessee at the time of disbursement of funds. This would depend on facts of each case.

Section 106 of the Indian Evidence Act or the principles analogous thereto places the burden in respect thereof upon the assessee, as the facts are within its special knowledge. However, a presumption may be raised in a given case as to why an assessee who for the purpose of running its business is required to borrow money from banks and

other financial institutions would be giving loan to its subsidiary companies and that too when it pays a heavy interest to its lenders, it would claim no or little interest from its subsidiaries."

Following the principles laid down in Abhishek Industries Ltd.'s case (supra), the substantial question of law, referred to above, is answered in favour of the revenue and against the assessee.

The appeal is disposed in the manner indicated above.

(Rajesh Bindal)
Judge

(Adarsh Kumar Goel)
Judge

October 12, 2006
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